

Oration 4: 1999 K.R. Narayanan Oration

Message from the President
of the Republic of India



I am glad that the annual lecture to commemorate the inauguration of the Australia South Asia Research Centre in April 1994 at The Australian National University has been taking place every year without interruption. These lectures delivered by distinguished economists have contributed meaningfully to the understanding of vital aspects of the South Asian economy in this period of change and reforms. I am glad to learn that this year the oration is given by Mr P. Chidambaram, a former Finance Minister of India who played a leading role in the liberalisation process of the Indian economy. Mr Chidambaram with his profound knowledge of economics and wide ranging experience in government and public life of India would, I am confident, make the lecture an illuminating exercise in the understanding of the complex process of economic transformation that is taking place in India in all its multiple dimensions.

It is refreshing that Mr Chidambaram will give special emphasis in his oration upon the third tier of government in India, that is, at the grassroots level. What invests the Indian experiment with depth and significance is that the reform process is not a superficial phenomenon affecting the upper crust of society, but involves the participation of millions of men and women at the village level. The Panchayati Raj institutions in India have made democratic decentralisation a reality. Three million elected representatives of the people at the grassroots level, 1 million of whom are women, are today participants in both decision-making and implementation of developmental programs at the grassroots level. The 474 District *panchayats*, 5,906 intermediate-level *panchayats* and over 227,000 village *panchayats* now constitute powerful self-propelled engines to promote the developments goals of the country. The success of this exercise of unprecedented scale in devolution of power has varied in different parts of the country depending on the extent of devolution of finances and responsibilities along with necessary training and capacity building. There is no doubt, however, of the potential for these evolving institutions to become vibrant vehicles of self-governance, transforming the quality of life in India's villages with democratic participation and paying heed to the demand for social justice by the generality of the people.

I am confident that Mr Chidambaram will more than do justice in his oration to this very import subject which has far reaching consequences for India's polity and development, and which would be of interest to all democratic countries.

K.R. Narayanan
New Delhi
1999

Stronger Branches, Deeper Roots: The Democratisation of India's Economic Reforms

P. Chidambaram

It is a privilege to be invited to The Australian National University. ANU has had a long association with India. Sir John Crawford, one of your former Chancellors, played a key role in the 1960s in making the Green Revolution possible in India, and we are grateful for that. Few institutions around the world have a centre dedicated to research on South Asia. This university has set an example by establishing the Australia South Asia Research Centre (ASARC). I have no doubt that the seed that was sown in 1994 will grow into a huge tree, providing opportunity to hundreds of scholars to study the unfolding South Asian drama.

There could have been no better occasion for me to visit here — which is also my first visit to your beautiful country — than to deliver the K.R. Narayanan Oration. It is my privilege to have known Mr Narayanan personally for many years. Mr Narayanan is a distinguished son of India and has impeccable intellectual and moral credentials. He has served his country with commitment and far-sightedness. His rise to the high office of President is a modern-day version of 'log cabin to the President's House', and throughout his life he had no assets other than hard work, integrity and humility. I hope I can measure up to the great honour attached to a lecture that bears his name.

The Development Challenge

India is a large and diverse country and its development has many dimensions. A population of nearly a billion people is just one aspect that sets it apart from most developing countries. True, China makes a good comparison. But China does not have the religious, ethnic, social or cultural variations and diversities that mark India. No other nation has such a large underclass — of backward castes and classes — that seeks empowerment. We cannot also forget that, unlike in many other developing countries, democracy has flourished in India for over five decades now and has struck deep roots. Its federal polity and the division of political power make the nature of State intervention in the economy somewhat different from other systems. Therefore, while comparisons with East Asia and China could certainly help in analysing India's economic trajectory and the success or failure of its policy responses, such an approach suffers from obvious limitations. India's development problem has to be probed on its own and solutions found that are specific to its needs. The theme that I have chosen for my lecture today rests on this premise. My endeavour would be to look at both the political and economic aspects of the development challenge in India.

Soon after India launched its reforms in 1991, its economy responded strongly to the bold initiatives taken by the government. The foreign exchange crisis of 1991 had brought down the GDP growth rate to a mere 0.8 per cent in 1991–92. The rebound thereafter was strong and, during the five years ending 1996–97, GDP growth rate averaged 6.9 per cent, the highest ever for a five-year period. This was accompanied by a turnaround in macroeconomic balances. The current account deficit improved from a high of 3.5 per cent in 1991 to 1.2 per cent in 1996–97 and the debt-service ratio declined from 32.4 per cent to 23 per cent. External debt as a percentage of GDP fell to 25 per cent in 1996–97 from a high of 37 per cent a few years earlier. Fiscal deficit of the Centre declined from 8.6 per cent in 1990–91 to 5.1 per cent in 1996–97. Foreign exchange reserves improved dramatically, rising from a mere \$1 billion to over \$27 billion now. And this has happened despite substantial liberalisation of the trade regime and reduction in tariffs.

While the improvement in the macro-economy has been remarkable, no less remarkable have been the changes that have taken place at the grassroots. Let me give you a flavour of the impact of economic reforms

on the rural population of India who constitute the bulk of our poor, illiterate and deprived. Between the National Sample Survey 46th round (July 1990 – June 1991) and the 53rd round (January 1997 – December 1997), the total number of employed in rural India increased from 268 million to 294 million, a gain of 26 million in the space of six years. While no accurate estimates are yet available for changes in rural per capita income, an indication can be had from the changes in real wages of unskilled agricultural labour. After a sharp decline in 1991–92, the first year of reform, real wages increased at an average annual rate of 3.6 per cent in the next six years. Gross capital formation in agriculture, another useful indicator, shows a 50 per cent rise at constant prices in the six years between 1991–92 and 1996–97. What is more remarkable is that there is a clear shift in favour of private investment in agriculture, and the share of private investment has increased from 75 per cent to 83 per cent. These changes are also reflected in the social indicators for rural India. Infant mortality rate for rural areas has declined from 86 per thousand live births to less than 80 per thousand (the national average is 71). Literacy in rural areas has improved from 44.7 per cent to 56 per cent (the national average is 62 per cent). The birth rate for the whole country has declined from 29.5 per thousand to 27.2 and the death rate from 9.8 per thousand to 8.9. These tentative trends are consistent with the view that rapid economic growth has brought about an improvement in the living standards of the people in general.

During the last two years, however, while macroeconomic balances have not deteriorated, growth rate of GDP has tended to slow down to about 5 per cent. The IMF's forecast for the current year (1999–2000) is that the GDP growth would once again be only 5.1 per cent. The sector responsible for the slowdown is manufacturing, where growth has slipped from a peak of 15 per cent in 1995–96 to less than 4 per cent in 1998–99. What has also raised concern is that during the '90s, as a whole, trend growth rate in agriculture has been lower than it was in the '80s.

Recent researches have confirmed that economic growth has contributed much more to reduction of poverty in India than subsidies or the government's anti-poverty interventions targeted at the poor. The rate of decline in the poverty ratio in the late 1980s and early 1990s has been double the rate achieved in the 1970s. This happened because the average growth rate of GDP improved from 3.5 per cent in the 1970s to 5.3 per cent in the 1980s and even higher to 7 per cent during 1994–95, 1995–96 and 1996–97. Clearly, India needs to sustain GDP growth rates

of 7 per cent plus to eliminate poverty over the next 15 to 20 years. What is also required is some sort of balanced growth across sectors because of the pivotal role of agricultural growth in poverty alleviation.

Three Constraints

Among the constraints to sustainability of high growth and poverty reduction in India, three are most apparent.

First, India's infrastructure is in urgent need of repair and expansion. Huge amounts need to be invested in ports, power generation and distribution, telecommunication, railways, roads and bridges, irrigation systems and water resources, infrastructure in urban and rural settlements, and afforestation and rehabilitation of degraded land.

Second, the quality of India's human resources is abysmally poor. India has the highest number of illiterate people among all countries. A third of India's children between the ages of six and 10 do not get to school. Of the children that do, a good number drop out well before they acquire the skills needed to earn a decent wage. India has also the world's largest share of children who remain malnourished. A large proportion of the Indian population does not have access to basic health care or basics like drinking water, shelter and toilets. Communicable diseases and prenatal and maternal mortality cause about 470 deaths per 100,000 persons in India — a rate four times that of China. In sum, a third of all Indians are poor, malnourished, illiterate and in bad health, and a robust growth rate of population only adds more to the bottom third of the Indian people. In a country like India, reduction in population growth becomes a crucial variable. Experience of some Indian States clearly suggests that a fall in population growth rate has strong linkages with social indicators like health and literacy, particularly of women.

Third, the government needs to redefine itself both in terms of what it should do and what it must spend on. While deregulation has already reduced the role of government in industry, infrastructure and services, and has expanded the space for the private sector, much more needs to be done. The process of privatisation remains tardy. But deregulation and privatisation alone will not help. This is because high fiscal deficits continue to threaten the sustainability of the growth process. Huge borrowings by the government hamper resource mobilisation by the private sector

and keep interest rates high. It follows that redefinition of government is closely linked with fiscal reform, especially reduction of the deficit and re-orientation of expenditure.

Trends in Indian Polity

It is necessary to look at these constraints within the setting provided by the emerging trends in the Indian polity and society. The most visible feature of the polity is the emergence of regional political and social forces and their urge for autonomy and empowerment. Over the last decade or so these urges have found a vehicle in regional political parties and they have played a key role in coalition governments at the Centre. The coalition governments have responded to the growing clout of regional parties by devolving more powers of decision-making from the Centre to the States. This trend cannot now be reversed as its roots go deep. Indeed, State governments are also under pressure to further decentralise power and resources to local bodies. Indian society is witnessing a process of great churning. The old order is dead. Sections at the lowest rung of society, the *dalits*¹ and the backward castes, minorities and women are now seeking social equality and their rightful place in the power structure. Alongside, there has been a surge in the activities of thousands of non-governmental organisations seeking to find decentralised solutions to developmental, cultural and social problems faced by the people. This social change, as well as the people's urge to participate in the development agenda and seek localised solutions to their problems, is bringing to the fore the role of local bodies, called Gram (i.e. village) *panchayats*, Nagarpalikas and Zila *parishads*.

The initial phase of reforms under the Congress government (1991–96) was driven by compulsion, external pressure and a few committed individuals. By a quirk of fate, many parties that had long opposed structural reforms came to power in 1996 under the banner of the United Front government. The United Front government surprised its critics by not only reaffirming the reform process but vigorously pursuing reforms in new areas. For instance, it was the United Front government which reformed direct taxes, began dismantling the administered price mechanism for

1 The former untouchables who suffer the worst discrimination.

petroleum products, and won the approval of the Inter-State Council (a body comprising the Chief Ministers of all the States) to accept 29 recommendations on Centre-State financial relations.

That government also introduced a slew of draft legislations ranging from company law to income tax to foreign exchange to insurance. The BJP-led government which assumed office in March 1998 came in with a reputation of being a right-wing coalition, rooted, however, not in reform but in atavism. After farcical posturing with outdated ideas like *Swadeshi* (self-reliance, or, more accurately, autarchy) and outrageous suggestions like withdrawal from WTO, the government settled down to the business of governance and categorically reaffirmed both the content and direction of the economic reforms that had started in 1991. The positive fall out of this was a new policy on information technology and a major overhaul of excise duties. Thus, the 1990s has witnessed the forging of an unspoken consensus among all the parties which cover the entire political spectrum of India. The Congress and the BJP have emerged as the two poles. Regional parties which dominated the United Front have shown a tendency to gather around one or the other pole. Many observers discern a definite trend towards a two-party system. While there is some basis for this conclusion, I do not think political life in India would ever be so simple. As the two major parties move towards the centre, they are in danger of losing their USP, although, I must confess, in the case of the BJP it would be better off if it loses its Unwanted Selling Points more rapidly! I also believe that there is political space for the Communist parties; there is space for a Green party as well. The two-party system would eventually dominate India's system with a peculiar Indian variation: the Congress and the BJP will be the two dominant parties at the Centre, but at the State level it is possible that the two-party system may be dominated by two regional parties excluding either or both the Congress and the BJP.

Even if single-party governments replace coalitions at the Centre, they will have to accommodate regional and sub-regional aspirations and even nurture them. They will also have to provide representation to backward castes, the *dalits*, the minorities and women. Indeed, both the leading national political parties, the Congress and BJP, are now supporting demands by sub-regional forces for formation of new States. Both are wooing the *dalits*, backward castes and minorities and debating legislation to reserve seats for women in elected bodies. There is a realisation across the political spectrum that if the country were to be governed effectively,

its diversity would have to be respected and nourished. The constraints to India's growth which I noted earlier would have to be addressed within this changing political matrix.

Indeed, this framework is no different from the one visualised by the architects of India's Constitution five decades ago. They clearly defined the division of responsibilities between the Centre and the States and enumerated them in the Union list, the States' list and the Concurrent list. These lists entrust the State governments with substantial responsibilities for development. Thus, States play a determining role in development of agriculture, water resources, land relations, environment and forests, rural roads and state highways, minor ports, electricity and rural and urban services. They are also responsible for human development through investments in key areas as health and education. To enable them to fulfil their responsibilities, the Constitution also empowers them with rights to raise taxes, get a share in funds available with the Centre, and levy user charges on various economic and social services provided to the people. The Constitution also provides for rights and responsibilities of local bodies like *panchayats* and municipal bodies. The Indian Constitution envisages that the States are as much, if not more, responsible for development as the Centre.

One may ask that if the framework was already provided for in the Constitution, then what went wrong? The framework worked, but only for a few years after independence. Thereafter, India suffered a phase when the Centre encroached upon the powers and autonomy of the States. The States in turn usurped the powers of local bodies. This was a logical fall-out of the centralised model of planned development India chose in the mid-'50s, which ensured that all economic decisions were directed by the Centre. The result was that the Centre sought to assume a larger responsibility for development than assigned to it in the Constitution. It floated centrally sponsored schemes and procrastinated on sharing all the tax revenues with State governments. States were required to seek clearances from the Centre for setting up projects for infrastructure and human development. Before the economic reforms of 1991, the States had little autonomy in attracting private domestic or foreign capital because investment, financial, industrial, sectoral and locational policies were controlled by the Centre. Local initiatives, especially initiatives that would have been possible through local bodies, perished under the

Centre-directed and Centre-controlled economic model of development. In turn, States neglected their local bodies: in many States local bodies ceased to exist as elections to such bodies were not held for 10–20 years.

The coincidence of economic reforms and the emergence of regional political forces in the '90s have acted as a catalyst to trigger devolution of power to the States. The United Front government (1996–98) offered to abolish or transfer to the States centrally sponsored schemes. It also liberalised policies to allow States to attract more private capital. The United Front government also accepted the recommendation of the Finance Commission that 29 per cent of all central tax revenues should be shared with the States. The change in the correlation of forces in favour of States is evident from the fact that the BJP-led coalition government that followed has continued with decentralising power to the States.

Is Empowerment of States Enough?

But empowerment of States is just one side of the coin. To deliver on the development front, the States will have to perform and not just rest content with acquiring more powers. The overall record thus far has been uninspiring. Most States' finances are in a mess and they often have to resort to overdrafts to pay salaries to their employees. The latest figures show that the States' combined fiscal deficit had increased to a high of 3.6 per cent of GDP. In 1985–86, this figure was 2.7 per cent.

Disturbingly, the States' fiscal deficit is rising not because they are spending more on development. The bulk of the States' expenditure is devoted to salaries and pensions, interest payments, and covering losses of public enterprises or losses incurred by electricity and irrigation boards. The interest burden on States has risen from 1.4 per cent of GDP in 1985–86 to 2.3 per cent now. Not surprisingly, their development effort is faltering: capital expenditure on social and economic services has fallen from 3.1 per cent of GDP in 1985–86 to around 2 per cent now. The States' expenditure on key social services like health and education is falling as a proportion of their total expenditure. Likewise, their commitment to developing critical infrastructure has weakened. They are unable to find resources even for maintenance of existing roads, public transportation systems and irrigation facilities. They cannot meet the growing energy needs of industry and agriculture because the state electricity boards have accumulated losses of over Rs 150 billion. The urban and rural settlements

are in a state of decay. And even as their wasteful expenditures are going beyond control, their taxation systems have lost the ability to deliver the revenue growth needed to plug the widening resources gap.

It will be evident that the three constraints to growth and development I outlined earlier are in full play at the level of the States. Since the States are responsible for a substantial part of the development effort, it is plain that reforms at the Centre alone cannot resolve the issue. The answer clearly lies in reforms at the State level: reforming States hold the key to India's economic future.

Fortunately, some States have seen the writing on the wall and launched welcome initiatives. Orissa, Haryana, Andhra Pradesh and Uttar Pradesh have launched comprehensive power sector reforms to dissolve their electricity boards and establish separate companies for generation and distribution of power, and have drawn up plans for privatisation of both generation and distribution. They have set up regulatory agencies to eliminate government's interference in the power sector, and to set tariffs for various categories of consumers. Hopefully, the huge subsidies being doled out will now be phased out and the power sector in these States would become financially sustainable. The power reforms experiment in these four States has motivated other States like Karnataka to launch similar reforms. Incidentally, these five States are ruled by five different political parties.

Similar initiatives have been launched in other areas of infrastructure. Karnataka and Andhra Pradesh have created infrastructure funds to boost investments in large infrastructure projects. Andhra Pradesh and Gujarat are upgrading their State highways and are revamping their road departments to improve the quality of road construction and maintenance. Many States are seeking private investors to rebuild high-density corridors into toll-based highways or expressways. Almost all States along India's large coastline are inducing private investors to build new ports on a BOT basis.

Some States have also launched new programs in the social sector. States like Rajasthan, Uttar Pradesh and Madhya Pradesh have embarked on improving their primary school systems to universalise primary education. Andhra Pradesh and Karnataka are reforming their health systems to improve the quality and reach of health services. Some States have launched ambitious programs for reproductive health and women and child development. Kerala and Tamil Nadu have already reached the replacement level of fertility of 2.1.

Fiscal Reform: The Critical Variable

While all these are steps in the right direction they still fall far short of the truly enormous requirements of the large Indian population. Even as many States are deregulating to woo private investors, it is obvious that private capital cannot satisfy all the requirements. There are critical areas in social sector and infrastructure where only the government can provide the necessary money as well as drive. Many of the programs, especially in the social sector, are not backed by fiscal reform and realignment of public expenditure. In the absence of fiscal reform, the critical minimum effort in infrastructure and human development is sadly missing. Fiscal reform at the state level is the one crucial element for redirecting State governments' energies towards the social sector and infrastructure.

Furthermore, these programs would not be sustainable unless they are conceived, designed and owned by the people and communities themselves. Most Indian States have large populations: a good number have more than 60 million people and one is large enough to qualify as the sixth largest country in the world! Within each State there are substantial regional variations in social structures and ethnicity, resource endowments, land relations, agro-climatic conditions, cropping patterns and the like. Quite often programs and projects conceived in State capitals fail to account for such variations, and communities are not taken into confidence. Also, centralised implementation of projects prevents transparency and vested interests tend to gain at the expense of the people. A good example is the plethora of anti-poverty programs and subsidies targeted at the poor. Their achievements in terms of poverty reduction have been found to be questionable and far from commensurate with the huge amount of funds poured into them. If the States have to ensure that reforms deliver at the grassroots they have no option but to decentralise in favour of local elected bodies at the village and municipal levels.

Panchayats: The Third Tier

Over two-thirds of the 1 billion Indian population lives in over 500,000 small villages and the remainder in a few thousand urban and semi-urban settlements. As I said earlier, the setting for development may change from one set of villages to another. To ensure that these varying needs are addressed and programs are implemented in a decentralised manner,

the Congress government under Rajiv Gandhi (1985–89) sought to strengthen the role of the ‘third tier’ in India’s administrative structure comprising elected local bodies. Subsequently in 1992, the Indian Parliament enacted two critical changes in the Indian Constitution, called the 73rd and 74th amendments, that created a multi-level structure of ‘Panchayati Raj’ institutions at the district, intermediate and village levels. The aim was to put in place elected local bodies as institutions of self-government and enhance their role in development.

This Constitutional and legal initiative opened a new window of opportunity for State governments to deal with the constraints that thwart India’s development. However, not many States have grabbed the opportunity and the establishments in State capitals continue to resist decentralisation of power and resources. Fortunately, some States are utilising the constitutional changes to empower their local bodies. A noteworthy example in this context is the manner in which Madhya Pradesh, a large Indian state, is implementing a program to universalise primary education through a program called the Education Guarantee Scheme (EGS). It has redefined the Indian State by including in it the village *panchayat* and the local community and excluding the civil service apparatus that allocates money and manages a large educational bureaucracy. Any community that has 25 children but does not have access to a primary school can demand a school. The demanders should select a locally available teacher and present a claim to the *gram panchayat*, which passes it on to the authorities at the district level. The district administration shall respond within 90 days of the demand. While the government lays down the curriculum and pays for textbooks, midday meals for children, and the salary and training of the teacher appointed by the village *panchayat*, the latter, along with the community, has to provide land for the school. This demand-driven system has been phenomenally successful: in 1998, over 40 primary schools have come up each day of the year. More has happened for primary education in Madhya Pradesh over the last two years than in the five decades prior to the launch of the EGS. The success of EGS belies the argument that tradition-bound communities are not alive to the value of education for their children. It also shows that they are willing to take charge of primary education for their children, and can do a better job than the bureaucracy.

Another bold initiative is underway in the state of Andhra Pradesh. In June 1997, the State legislature passed the *Andhra Pradesh Farmers Management of Irrigation Systems Act*. The Act provides for creation of

Water Users Associations all over the State which in turn elect their Managing Committees. The State government has empowered the WUAs and their committees to manage the irrigation systems at the level of the village — i.e. beyond the main feeder canal. They maintain records of water use, collect dues from member farmers, ensure proper distribution of water, and are also allowed to spend on repair and maintenance of the network. Over 10,000 such associations have been formed. Preliminary assessments show better maintenance of the irrigation system, increase in the area of cultivated land and improved collection of revenues. This needs to be set against the abysmal performance of irrigation departments in most States, which are bankrupt, and unable to maintain the existing channels, let alone create new ones.

The government of Andhra Pradesh has launched another new development initiative called 'Janmabhoomi'. The program is based on identification and prioritisation of needs by the communities themselves through the institution of the village *panchayat*. People share the cost of community works to which government also contributes, they execute the works through self-help groups, review and audit the expenditure and own the assets thus created. The projects executed through the program include roads, drains, buildings for schools and colleges, drinking water, health clinics, irrigation facilities, etc. Over the last two years a number of such projects have been completed and commissioned. Even allowing for some waste and leakages, assets worth billions of rupees have been added to the community, and there is a growing sense of community ownership and responsibility.

Many more such community-based programs are under implementation in the States. The common feature that marks all such success stories is participation by people's institutions like elected local bodies, self-help groups or cooperatives. True, in all these success stories there are other features like meticulous planning, social leadership, external technological and managerial inputs and availability of resources. However, there is little doubt that people's participation, and the resulting beneficiary orientation of such schemes, has been the critical input.

Another feature of successful development programs has been their holistic approach. It has been realised that the development of the poor cannot be achieved through any one single activity. Development has to be a multidimensional process that addresses problems of illiteracy, ill health and infrastructure. The range of activities being addressed in

the Janmabhoomi program in Andhra Pradesh illustrates this point. Janmabhoomi also confirms the fundamental fact that only programs identified by the community deliver the maximum results. Development occurs when it is an interactive and democratic process, because then alone it addresses the numerous dimensions of backwardness.

As I said earlier, the potential for sustainable development revealed by the 73rd and 74th amendments is still not being tapped by most State governments, although some have begun to move in that direction. In most States, the power elite continues to resist decentralisation, and implementation of 'Panchayati Raj' has turned out to be an exercise in bureaucratic expansion. The concept itself continues to be plagued by numerous problems. There are legal ambiguities that allow States to keep local bodies weak and ineffective, and some more constitutional changes may be necessary to plug the loopholes. Another problem is the lack of resources available to local bodies, as State governments and State Finance Commissions have yet to work out the terms of sharing of taxable resources. Local bodies have also not yet been fully empowered to levy and collect taxes, user charges and other revenues. Only in a few cases have municipalities been allowed to issue bonds. Another hurdle is the limited expertise at the village level considering the high levels of illiteracy among village communities and their relative isolation. And not to be overlooked is that the villages and communities have their own elite and inequitable power structures, patron-client relations, and caste equations, which resist and arrest any social or economic change. There are numerous such problems that I need not spell out here. Scholars at this Centre interested in pursuing the subject can easily dip into the vast body of literature available.

The Tree: With Branches and Roots

Friends, a discussion on economic reforms in India tends to look at what the Indian government in New Delhi is doing. Investors and even scholars often base their judgement on the pace and quality of reforms by assessing the actions of the Central government. There cannot be any doubt that the overall policy environment has to be created by the Centre. For instance, some of the constraints to growth in India lie in the policies concerning the financial sector, international trade, privatisation of public sector enterprises, legal systems, taxation, and fiscal issues like

subsidies. The Central government has to continue reforms in all these areas to improve the environment for growth and development. None can underestimate the catalytic role played by the policy framework created by the Centre.

But the role of the Central government in the Indian reform process ought not to be exaggerated either. For example, fiscal reforms, easily the most important macroeconomic issue, cannot be assessed only in terms of measures outlined in the central budget. Fiscal deficits in the States are as substantial and as relevant. My endeavour today has been to draw your attention to the large and crucial space occupied by two other layers in the institutional framework for reform in India: the State governments and the third tier comprising local bodies or other elected community-based organisations. India cannot sustain high rates of growth and make its people prosper without activating these two layers as well. Indeed, all three have to move in tandem, with each one reinforcing and invigorating the other. If the policy framework at the Centre is the main trunk of the Indian tree of development, the States are like its branches and local bodies and people-based organisations are its roots. The tree can grow bigger and its trunk more sturdy only if the branches are stronger and wider and the roots go deeper into the earth. I can see democracy driving this process in India.

We have put behind us the years when moderate growth rates ensured small islands of prosperity in a sea of poverty. Today, every section of the Indian people aspires for a better life. For the very poor, better life will mean, in their lifetime, perhaps no more than better water, better housing, better schools, and better medical care. The road to that better life is in better governance, and the very poor have awakened to the fact that self-governance is indeed better governance. The 73rd and 74th Amendments to the Indian Constitution ensured the democratisation of India's polity. Out of 227,000 village *panchayats*, fully one-third are headed by women. The *dalits* control up to 22.5 per cent of the elected offices. The minorities and the backward castes have also discovered 'empowerment'. Driven by aspiration and fortified by empowerment, the people of India will reap the benefits of an open and competitive economy. More and more people will share the benefits of growth and development.

The democratisation of India's economy is underway. And therein lies the reason for our hopes and our dreams.

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